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SIPDIS

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SUBJECT: MALAWI APPROVES BUDGET IN TIME FOR HIPC REVIEW

REF: A) LILONGWE 654 B) LILONGWE 437

1. (SBU) SUMMARY: ON THE HEELS OF THE BOTCHED HANDLING OF A CORRUPTION CASE AGAINST FORMER PRESIDENT BAKILI MULUZI (REF A), THE GOVERNMENT OF MALAWI MANAGED TO PASS THE NATIONAL BUDGET ON AUGUST 3 AFTER WEEKS OF TENSE, PROTRACTED WRANGLING WITH THE OPPOSITION-DOMINATED PARLIAMENT. THE OPPOSITION EXTRACTED SEVERAL CONCESSIONS, INCLUDING INCREASED FUNDING FOR MPS AND THE QUIET DISCONTINUATION OF THE MULUZI CASE, IN EXCHANGE FOR PASSAGE OF THE BUDGET. THE GOM REMAINS ON TRACK FOR DEBT RELIEF UNDER THE HIGHLY INDEBTED POOR COUNTRIES (HIPC) PROGRAM, WHICH IS EXPECTED TO OCCUR LATER THIS YEAR. END SUMMARY.

2. (SBU) MALAWI'S NATIONAL ASSEMBLY APPROVED ITS FY 2006/07 BUDGET TOTALING MWK 140.7 BILLION (USD 1.03 BILLION) ON AUGUST 3. THE MAJORITY (BUT ORDINARILY DIVISIVE) OPPOSITION SUCCESSFULLY RALLIED TO CHANGE SEVERAL LINE ITEMS AND TO DELAY APPROVAL OF THE ALLOCATION FOR THE MINISTRY OF INFORMATION AND TOURISM, WHOSE MINISTER, PATRICIA KALIATI, REFUSED TO APOLOGIZE TO OPPOSITION LEADERS AFTER CASTIGATING THEM DURING A JULY PRESS CONFERENCE. PARLIAMENT FINALLY MANAGED TO PASS THE BUDGET AFTER BARRING KALIATI FROM THE PROCEEDINGS.

3. (SBU) DEMANDS BY THE OPPOSITION TO INCREASE ALLOCATIONS FOR SEVERAL LINE ITEMS - INCLUDING FERTILIZER SUBSIDIES, LEGISLATIVE SALARIES, AND FUNDING FOR LOCAL GOVERNMENT ELECTIONS - RESULTED IN A USD 14.6 MILLION INCREASE OVER GOVERNMENT'S ORIGINAL REQUEST. THE FERTILIZER SUBSIDY BILL ROSE FROM USD 40 MILLION TO USD 53 MILLION, REFLECTING HIGHER THAN ANTICIPATED QUOTES FOR THE PURCHASE OF FERTILIZER. THE INCREASED BUDGET REQUIRES GOVERNMENT TO RECALCULATE THE FINANCING MECHANISM TO COVER THE LARGER THAN ANTICIPATED BUDGET DEFICIT OF USD 43 MILLION (2 PERCENT OF GDP).

4. (SBU) MALAWI'S RECURRENT BUDGET IS HEAVILY SUPPLEMENTED BY DONOR INFLOWS AMOUNTING TO MORE THAN 40 PERCENT. NONE OF THE DONORS PROVIDING BUDGET SUPPORT HAVE SO FAR PROTESTED AGAINST THE APPROPRIATION INCREASE. INTERNATIONAL MONETARY FUND (IMF) COUNTRY REPRESENTATIVE THOMAS BAUNSGAARD TOLD ECONOFF THAT THE REVISED FERTILIZER FIGURE REFLECTED MORE PRAGMATIC BUDGETING BASED ON ACTUAL QUOTES. HE VIEWED THIS AS AN IMPROVEMENT OVER LAST YEAR'S PLANNING, WHICH VASTLY UNDERESTIMATED FERTILIZER PRICES, RESULTING IN SIGNIFICANT COST OVERRUNS. BAUNSGAARD NOTED THAT THE BUDGET WAS IN LINE WITH THE POVERTY REDUCTION AND GROWTH FACILITY (PRGF)

FRAMEWORK, AND SPECULATED THAT OVERPERFORMANCE IN TAX COLLECTION WOULD HELP OFFSET THE DEFICIT. IT REMAINS TO BE SEEN HOW GOVERNMENT WILL MANAGE TO MAKE UP THE REMAINDER OF THE DIFFERENCE.

15. (U) THE 2006/07 BUDGET RESOURCE PACKAGE INCLUDES DEBT CANCELLATION BENEFITS OF USD 30 MILLION. PASSING OF THE BUDGET WAS REQUIRED FOR SUCCESSFUL PRGF PROGRAM REVIEW, A NECESSARY CONDITION FOR MALAWI REACHING THE HIPC COMPLETION POINT AND DEBT CANCELLATION. THE GOM APPEARS TO BE ON TRACK FOR HIPC COMPLETION THIS YEAR (REF B). OVERALL PERFORMANCE UNDER PRGF HAS BEEN POSITIVE, AND MISSED HIPC TRIGGERS IN THE HEALTH AND EDUCATION SECTORS MAY BE WAIVED.

16. (SBU) COMMENT: PASSING THIS YEAR'S BUDGET REQUIRED SHREWD POLITICAL MANEUVERING BY FINANCE MINISTER GOODALL GONDWE, WHO UNDERSTOOD BETTER THAN ANYONE THE NEED TO COMPROMISE IN ORDER TO SECURE THE GREATER OBJECTIVE OF DEBT RELIEF. LOCAL IMF AND WORLD BANK (WB) REPRESENTATIVES HAVE INDICATED THAT MALAWI IS MORE OR LESS ON TRACK FOR HIPC QUALIFICATION BASED ON ECONOMIC TARGETS (I.E., SATISFACTORY PRGF IMPLEMENTATION AND GOOD MACROECONOMIC PERFORMANCE) AND EXPECT THE IMF BOARD TO CONVENE AROUND THE END OF AUGUST TO MAKE A DETERMINATION. EASTHAM